

**STATE OF NEW JERSEY
HEALTH BENEFITS PROGRAM FUND,
DENTAL EXPENSE PROGRAM FUND,
PRESCRIPTION DRUG PROGRAM FUND,
ALTERNATE BENEFIT PROGRAM FUND, AND
ALTERNATE BENEFIT LONG-TERM DISABILITY FUND**

Financial Statements and Schedule

June 30, 2000

(With Independent Auditors' Report Thereon)

KPMG LLP
Princeton Pike Corporate Center
P.O. Box 7348
Princeton, NJ 08543-7348

Independent Auditors' Report

Office of Legislative Services
Office of the State Auditor
State of New Jersey:

We have audited the accompanying balance sheets of the State of New Jersey Health Benefits Program Fund, Dental Expense Program Fund, Prescription Drug Program Fund, Alternate Benefit Program Fund and Alternate Benefit Long-Term Disability Fund as of June 30, 2000, and the related statements of revenues, expenditures, and changes in fund balances for the year then ended. These financial statements are the responsibility of the Funds' management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State of New Jersey Health Benefits Program Fund, Dental Expense Program Fund, Prescription Drug Program Fund, Alternate Benefit Program Fund and Alternate Benefit Long-Term Disability Fund as of June 30, 2000, and the changes in its fund balances for the year then ended in conformity with accounting principles generally accepted in the United States of America.

September 8, 2000

KPMG LLP

STATE OF NEW JERSEY
HEALTH BENEFITS PROGRAM FUND, DENTAL EXPENSE
PROGRAM FUND, PRESCRIPTION DRUG PROGRAM FUND,
ALTERNATE BENEFIT PROGRAM FUND, AND ALTERNATE
BENEFIT LONG-TERM DISABILITY FUND

Balance Sheets

June 30, 2000

	HEALTH BENEFITS PROGRAM FUND	DENTAL EXPENSE PROGRAM FUND	PRESCRIPTION DRUG PROGRAM FUND	ALTERNATE BENEFIT PROGRAM FUND	ALTERNATE BENEFIT LONG - TERM DISABILITY FUND
Assets					
Cash and cash equivalents	\$ —	\$ 186,652	\$ 18,310	\$ 25,641	\$ —
Investments, at fair value:					
U.S. Treasury notes	—	—	—	—	—
Cash Management Fund	233,359,247	7,241,489	11,531,531	5,680,302	3,175,723
Total investments	233,359,247	7,241,489	11,531,531	5,680,302	3,175,723
Receivables:					
Other	41,085,362	407,799	525,702	22,530	—
Due from other funds	45,470,950	4,455,299	2,214,251	7,120,952	—
Total receivables	86,556,312	4,863,098	2,739,953	7,143,482	—
Total assets	\$ 319,915,559	12,291,239	14,289,794	12,849,425	3,175,723
Liabilities					
Accounts payable and					
accrued expenses	256,037,125	5,074,545	8,539,000	11,411,106	—
Deferred revenue	2,804,949	934,552	—	—	—
Due to other funds	8,071	—	7,643,934	1,438,319	—
Total liabilities	258,850,145	6,009,097	16,182,934	12,849,425	—
Fund balances					
Fund balances (deficit):					
Reserved	61,065,414	6,282,142	(1,893,140)	—	3,175,723
Total liabilities and fund balances	\$ 319,915,559	\$12,291,239	\$14,289,794	\$12,849,425	\$ 3,175,723

See accompanying notes to financial statements.

STATE OF NEW JERSEY
HEALTH BENEFITS PROGRAM FUND, DENTAL EXPENSE
PROGRAM FUND, PRESCRIPTION DRUG PROGRAM FUND, AND
ALTERNATE BENEFIT LONG-TERM DISABILITY FUND
Statements of Revenues, Expenditures, and Changes in Fund Balances
Year ended June 30, 2000

	HEALTH BENEFITS PROGRAM FUND	DENTAL EXPENSE PROGRAM FUND	PRESCRIPTION DRUG PROGRAM FUND	ALTERNATE BENEFIT LONG - TERM DISABILITY FUND
Revenues and additions:				
Contributions:				
Members	\$ 78,130,829	\$ 23,749,677	\$ 839,331	\$ —
Employers	1,215,222,298	23,211,344	138,016,526	988,064
Total contributions	1,293,353,127	46,961,021	138,855,857	988,064
Investment income:				
Net appreciation (depreciation) in fair value of investments	(47,735)	4,638	(2,359)	2,153
Interest	15,613,855	432,515	553,899	245,412
Total investment income	15,566,120	437,153	551,540	247,565
Total revenues and additions	1,308,919,247	47,398,174	139,407,397	1,235,629
Expenditures and deductions:				
Benefits	1,392,310,541	46,143,271	139,093,958	1,241,700
Administrative expense	6,407,535	1,761,355	—	—
Total expenditures and deductions	1,398,718,076	47,904,626	139,093,958	1,241,700
Net increase (decrease)	(89,798,829)	(506,452)	313,439	(6,071)
Fund balances:				
Beginning of year	150,864,243	6,788,594	(2,206,579)	3,181,794
End of year	\$ 61,065,414	\$ 6,282,142	\$ (1,893,140)	\$ 3,175,723

See accompanying notes to financial statements.

**STATE OF NEW JERSEY
HEALTH BENEFITS PROGRAM FUND, DENTAL EXPENSE
PROGRAM FUND, PRESCRIPTION DRUG PROGRAM FUND,
ALTERNATE BENEFIT PROGRAM FUND, AND ALTERNATE
BENEFIT LONG-TERM DISABILITY FUND**

Notes to Financial Statements
June 30, 2000

(1) DESCRIPTION OF THE FUNDS

The State of New Jersey sponsors and administers the following expendable trust funds and agency fund which have been included in the accompanying financial statements of the State of New Jersey Division of Pensions and Benefits:

Expendable Trust Funds:

State Health Benefits Program Fund (SHBP)
Dental Expense Program Fund (DEPF)
Prescription Drug Program Fund (PDPF)
Alternate Benefit Long-Term Disability Fund (ABPLTD)

Agency Fund:

Alternate Benefit Program Fund (ABP)

The financial statements of these trust and agency funds (the Funds) have been prepared in conformity with generally accepted accounting principles as applied to governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the Division's accounting policies are described below:

Fund Accounting

The accounts of the Division are maintained in accordance with the principles of fund accounting to ensure observance of limitations and restrictions on the resources available. The principles of fund accounting require that the resources be classified for accounting and reporting purposes into funds in accordance with activities or objectives specified for the resources. Each fund is a separate accounting entity with a self-balancing set of accounts. All funds are classified as fiduciary.

Fiduciary Funds

Trust and agency funds - The trust and agency funds are used to account for assets held by the Division on behalf of outside parties, including plan participants and the State of New Jersey.

Agency funds - Agency funds are used to account for the assets that the Division holds on behalf of others as their agent. Agency funds are custodial in nature and do not involve measurement of results of operations.

The Funds are administered by the Division of Pensions and Benefits (the Division). Operating controls over the Funds are with the individual funds' and trusts' governing Boards and/or the State of New Jersey. The financial statements of the Funds are included in the financial statement of the State of New Jersey; however, the accompanying financial statements are intended solely to present certain funds administered by the Division and not the State of New Jersey as a whole.

Description of the Fund - SHBP

The Health Benefits Program Fund is a pay-as-you-go expendable trust fund which was established in 1961 by N.J.S.A. 52:14-17.25 et seq. The Fund is included along with other state-administered funds, systems and trusts

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PROGRAM FUND, PRESCRIPTION DRUG PROGRAM FUND,
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Notes to Financial Statements, Continued

(1) DESCRIPTION OF THE FUNDS, Continued

in the general purpose financial statements of the State of New Jersey.

The State Health Benefits Program was established by Chapter 49, P.L. 1961 to provide traditional indemnity plan benefits to State employees. The program was later extended under Chapter 125, P.L. 1964 to include public and school district employees of participating counties, municipalities, school districts, and public agencies. Chapter 337, P.L. 1973 authorized the establishment of Health Maintenance Organizations (HMOs) to be offered to both State and local employers. The first HMO enrollment took place in 1976. In 1989, the State Health Benefits Commission introduced a point-of-service plan known as NJ PLUS, which is a combination of a traditional or indemnity plan and an HMO.

The traditional indemnity plan and NJ PLUS are self-insured plans. Administrative services for these plans are provided by a third party insurance company. Currently, three HMOs participating in the program (Horizon HMO, Aetna/US Healthcare and Cigna) are self-insured plans. The remaining four HMOs are on an insured basis.

Description of the Fund - PDPF

The Prescription Drug Program Fund is a pay-as-you-go expendable trust fund established on December 1, 1974 as authorized by N.J.S.A. 52:14-17:29. This program initially covered only certain state groups as a result of union negotiations; however, under Chapter 41, P.L. 1976, coverage was extended to all eligible State employees, including those not in the collective bargaining units. The State Health Benefits Commission offered the program to local employers that participated in the SHBP on July 1, 1993.

Description of the Fund - DEPF

The Dental Expense Program Fund is a pay-as-you-go expendable trust fund established on February 1, 1978 by N.J.S.A. 52:14-17:29 for State employees only. The program, which initially offered one traditional indemnity plan, was expanded in June of 1984 to include dental provider organizations.

Description of the Fund - ABPLTD

The Alternate Benefit Long Term Disability Fund is an expendable trust fund established on October 1, 1986 to provide disability benefits to those members of the Alternate Benefit Program who have been disabled for two years or more since October 1, 1986. The ABPLTD is funded on a reserve basis. Contributions are made to the fund as required to maintain a reserve equal to the full projected cost of providing disability benefits to the limiting age of 70.

Description of the Fund - ABP

The Alternate Benefit Program is a tax deferred, defined contribution plan under code section 403b which was established by N.J.S.A. 18A:66-167 et seq. to permit full time faculty members of public institutions of higher education to transfer their interest in the State defined benefit plans to this program, thereby establishing a portable pension plan. Presently, the ABP covers higher education faculty and certain administrators employed by the Commission on Higher Education, the Office of Student Assistance, the State universities, the State colleges, and the county colleges.

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Notes to Financial Statements, Continued

(1) DESCRIPTION OF THE FUNDS, Continued

Vesting and Benefit Provisions - SHBP

The Program provides medical coverage to qualified active and retired participants. Under Chapter 136, P.L. 1977, the State of New Jersey pays for the health insurance coverage of all enrolled retired State employees (regardless of age) whose pensions are based upon 25 years or more of credited service or a disability retirement regardless of years of service. The State of New Jersey also provides free coverage to members of the Public Employees' Retirement System and the Alternate Benefit Program who retire from a board of education or county college with 25 years of service or on a disability retirement. Partially funded benefits are also provided to local police officers and firefighters who retire with 25 years of service (or on disability) from an employer who does not provide coverage. Retirees who are not eligible for employer paid health coverage at retirement can continue in the program by paying the cost of the insurance for themselves and their covered dependents.

Benefit Provisions - PDPF

The Program provides coverage to employees and their eligible dependents for drugs which under federal or State law may be dispensed only upon a prescription written by a physician. State and local employees are eligible for coverage after 60 days of employment.

Benefit Provisions - DEPF

The Program provides coverage to employees and their eligible dependents for dental services performed by a qualified dentist. State employees are eligible for coverage after 60 days of employment.

Benefit Provisions - ABPLTD

Members who are totally disabled due to an occupational or nonoccupational condition are eligible to receive a regular monthly benefit equal to 60% of the base salary earned over the 12 month period preceding the onset of the disability. The long-term disability benefits continue until such time as the member retires or attains the age of 70, whichever comes first.

Vesting and Benefit Provisions - ABP

The Alternate Benefit Program provides retirement benefits, disability benefits, and group life insurance benefits to eligible participants. Retirement benefits are payable upon separation from service with no age or service requirements. However, distributions under age 55 are limited to employee contributions and accumulations. The remaining employer's contributions and earnings are available for distribution upon attaining age 55. Participants are immediately vested if the participant has an existing retirement account containing employer and employee contributions based on employment in public education, or is an active or vested member of a federal or state retirement system.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements

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Notes to Financial Statements, Continued

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

of these funds present increases, i.e., revenues and other financing additions, and decreases, i.e., expenditures and other deductions, in net assets.

The modified accrual basis of accounting is used for measuring financial position and changes in financial position for expendable trust funds. Under this method, revenues are recognized when measurable and available and expenditures are recognized when incurred and measurable.

Fixed Assets

Fixed assets utilized by the Division include equipment which is owned by the State of New Jersey and is included in the general fixed asset account group of the State of New Jersey.

Investment Valuation

Investments, including short-term investments (State of New Jersey Cash Management Funds) are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair values.

The State of New Jersey Division of Investment, under the jurisdiction of the State Investment Council, has the investment responsibility for all funds administered by the State of New Jersey Division of Pensions and Benefits. All investments must conform to standards set by state law.

The State of New Jersey, Department of the Treasury, Division of Investment, issues publicly available financial reports that include the financial statements of the State of New Jersey Cash Management Fund, Common Pension Fund A, Common Pension Fund B and Common Pension Fund D. The financial reports may be obtained by writing to the State of New Jersey, Department of the Treasury, Division of Investment, P.O. Box 290, Trenton, New Jersey 08625-0290.

The purchase, sale, receipt of income, and other transactions affecting investments are governed by custodial agreements between the Funds, through the State Treasurer, and custodian banks as agents for the Funds. State laws and policies set forth the requirements of such agreements and other particulars as to the size of the custodial institutions, amount of the portfolio to be covered by the agreements, and other pertinent matters.

GASB Statement No. 3 requires disclosure of the level of custodial risk assumed by the Funds. Category 1 includes investments that are insured or registered or for which the securities are held by the Funds or its agent in the Funds' name. As of June 30, 2000, all investments held by the Funds (other than the State of New Jersey Cash Management Funds which are not categorized) are classified as Category 1.

Federal securities are maintained at Federal Reserve Banks in Philadelphia and New York through the custodian banks in trust for the Funds. A significant portion of corporate equity and debt securities are maintained by the Depository Trust Company (DTC) through the custodian banks in trust for the Funds. The custodian banks as agents for the Funds maintain internal accounting records identifying the securities maintained by the Federal Reserve Banks and the DTC as securities owned by or pledged to the Funds.

Securities not maintained by the Federal Reserve Banks or DTC are in the name of a designated nominee representing the securities of the Funds, which establishes the Funds' unconditional right to the securities.

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Notes to Financial Statements, Continued

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES Continued

Membership

Membership in the Funds consisted of the following as of June 30, 2000:

	STATE	LOCAL	TOTAL
Health Benefits Program Fund *	127,153	176,127	303,280
Prescription Drug Program Fund	101,002	17,358	118,360
Dental Expense Program Fund	85,842	—	85,842
Alternate Benefit Program Fund **	13,242	2,733	15,975

**active and retired participants*

*** including those receiving long-term disability benefits*

Administrative Expenses

Administrative expenses are paid by the Funds to the State of New Jersey, Department of the Treasury and are included in the accompanying statements of revenues, expenditures and changes in fund balances.

Income Tax Status

Based on a 1986 declaration of the Attorney General of the State of New Jersey, the Funds are qualified plans as described in Section 401(a) of the Internal Revenue Code.

Cash and Cash Equivalents

GASB Statement No. 3 also requires that deposits held in financial institutions be categorized to indicate the level of risk assumed by the entity. Category 1 consists of deposits that are insured or collateralized with securities held by the entity or by its agent in the entity's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institutions trust department or agent in the entity's name. Category 3 consists of deposits which are uncollateralized.

Based upon aggregate collateral levels maintained for all State bank accounts as a whole, substantially all cash balances maintained in financial institutions as of June 30, 2000, which includes funding for the July 1, 2000 retirement payroll, are designated category 3.

The categorization of cash and cash equivalents for all State funds, including the pension trust funds, can be found in the notes to the general purpose financial statements of the State of New Jersey.

The State Health Benefits Program Fund has a negative book balance of \$364,890 representing a managed overdraft which has been reclassified and is included in the accounts payable balance on the balance sheet.

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Notes to Financial Statements, Continued

(3) CONTRIBUTIONS

Contribution Requirements - SHBP

Contributions to pay for the health premiums of participating employees in the State Health Benefits Program (SHBP) are collected from the State of New Jersey, participating local employers, active members, retired members, the Public Employees' Retirement System (PERS), and the Teachers' Pension and Annuity Fund (TPAF). The State of New Jersey provides contributions for State employees through State appropriations. These appropriations are generally distributed to the SHBP on a monthly basis. Local employer payments, active and retired member contributions, and payments from the PERS and TPAF are generally received on a monthly basis. Certain State employees share in the cost of their premiums, as provided by Chapter 8, P.L. 1996.

Under the provisions of Chapter 8, P.L. 1996, the SHBP implemented premium sharing for employees covered under the State component of the program. Chapter 8 authorizes the State to negotiate premium sharing in the collective bargaining agreements governing employment of State employees. Premium sharing also applies to retired group coverage for employees who attain 25 years of creditable pension service after July 1, 1997 or who retire on a disability retirement after that same date. Those employees not represented by any bargaining unit premium share in accordance with rules established by the State Health Benefits Commission. Local group employees are not affected by the premium sharing provisions of Chapter 8, P.L. 1996.

Contribution Requirements - PDPF

Contributions to pay for the premiums of participating employees in the Prescription Drug Plan are collected from the State of New Jersey, participating local employers, and former active and retired members who have elected to participate under the rules of COBRA. The State of New Jersey provides contributions for State employees through State appropriations. These appropriations are distributed to the Prescription Drug Plan on a monthly basis. Local employer payments as well as COBRA contributions are also received on a monthly basis.

Contribution Requirements - DEPF

Contributions to pay for the premiums of participating employees in the State Employee Dental Program are collected from the State of New Jersey, active employees, and former and retired members who have elected to participate under the rules of COBRA. The cost of the premiums is shared equally by the State of New Jersey and active State employees. Former and retired employees who have chosen to participate under the rules of COBRA pay the full cost of the premium. The State of New Jersey provides contributions through State appropriations. These appropriations are distributed to the SHBP on a biweekly and monthly basis. The active member share of the cost of premiums is paid to the State on a biweekly and monthly basis. Members participating under COBRA remit their payments on a monthly basis.

Contribution Requirements - ABPLTD

The State of New Jersey makes an annual contribution to the ABPLTD, as required, toward the cost of long-term disability benefits which extend beyond the calendar year following the year in which the disability benefits commence for those with a benefit commencement date on or after October 1, 1986.

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Notes to Financial Statements, Continued

(3) CONTRIBUTIONS, Continued

Contribution Requirements - ABP

Members contribute a mandatory 5% of base or contractual salary that is tax deferred under the 414(h) provisions of the Internal Revenue code. Members are also permitted to make voluntary federal tax-deferred contributions under Internal Revenue Code Section 403(b). The State of New Jersey pays the employer contribution for all State and county employees participating in the plan. The employer contribution is based on 8% of base or contractual salary. The State of New Jersey is also responsible for the cost of noncontributory life insurance coverage and long term disability coverage for its plan members.

(4) RESERVES

The fund balances of the SHBP, PDPF, and DEPF are available to pay claims of future periods. These reserves are maintained by the Funds to stabilize rates and assure the ability to meet unexpected increases in claims. For the ABPLTD, the reserves are for future payments to participants.

The PDPF has a fund deficit of \$1,893,140 as of June 30, 2000. In order to compensate for the FY 2000 deficit, rates from July 2000 to December 2001 were increased by 27.9% for the State group and 27.7% for the local group. The State Health Benefits Commission will further review these changes when it considers the rates to be charged in January 2002.

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Schedule of Changes in Assets and Liabilities
(Agency fund)

Year ended June 30, 2000

ALTERNATE BENEFIT PROGRAM FUND

	BALANCE JULY 1, 1999	ADDITIONS	DEDUCTIONS	BALANCE JUNE 30, 2000
Assets				
Cash and cash equivalents	\$ —	3,630,937	3,605,296	\$ 25,641
Investments, at fair value:				
Cash Management Fund	4,979,683	93,867,605	93,166,986	5,680,302
Total investments	4,979,683	93,867,605	93,166,986	5,680,302
Receivables:				
Other	1,403,424	22,530	1,403,424	22,530
Due from other funds	6,436,913	7,120,952	6,436,913	7,120,952
Total receivables	7,840,337	7,143,482	7,840,337	7,143,482
Total assets	\$ 12,820,020	104,642,024	104,612,619	12,849,425
Liabilities				
Accounts payable and accrued expenses	9,980,771	12,495,938	11,065,603	11,411,106
Due to other funds	2,839,249	1,710,174	3,111,104	1,438,319
Total liabilities	\$ 12,820,020	14,206,112	14,176,707	\$ 12,849,425